



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT
FOR APRIL 2006**

DATE: June 12, 2006

Approved	/s/	Date	06/12/06
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INFORMATION ONLY

The Monthly Financial Report (MFR) for April was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

OVERVIEW

Through ten months of the year, our review of the financial status of the City continues to indicate that the City's fiscal climate is consistent with the chief assumptions used to build the 2005-2006 Adopted Budget: (1) the severe downturn experienced by the City over the last four years has bottomed out, (2) we have experienced a resumption of moderate growth in our economically sensitive revenues, and (3) there continue to be no signs indicating a resumption of economic growth levels resembling that experienced in the late 1990's.

At the national level and in California the economy continues in a modest growth mode, although there are indications those growths levels are slowing down. The risk factors, both national and local, which have been mentioned in past MFRs continue to be of concern and must be monitored as threats to the economic environment. These factors include: the continuation of a stagnant local job market; the national spike in fuel prices; a softening in the real estate market, which at least locally has the potential to develop into a market bubble burst; the continued rise in interest rates; the large and growing Federal deficit; and uncertainty in consumer confidence levels both nationally and locally.

Most economists continue to believe that while these factors will almost certainly cause growth at the national economy to slow, a disruption severe enough to lead to a return to a recessionary condition is unlikely. But most also express caution concerning the possibility of a worse outcome.

At the State level, the UCLA Anderson Forecast, the source we believe to be the most accurate source of California economic projections, also continues to repeat the warning that it has been providing for some time about the existence and impact of a housing "bubble", which it believes strongly exists in many parts of the State, including, if not especially, the Bay Area.

OVERVIEW (CONT'D.)

However, consistent with the consensus discussed above, that organization's assessment still predicts that if the market deflates in an orderly fashion, it will likely only slow the State's economy, not drive it into a recession. The report does also predict, however, that this will lead to job losses in housing-related industries, such as construction and finance, and that the result will probably be a couple of years of what the UCLA forecasters call "anemic" growth for the California economy. Given the extremely high levels of real estate activity and price growth experience locally over the last several years and the sustaining affect that this has had on an otherwise hard hit economy, we will need to watch this situation closely in the coming months.

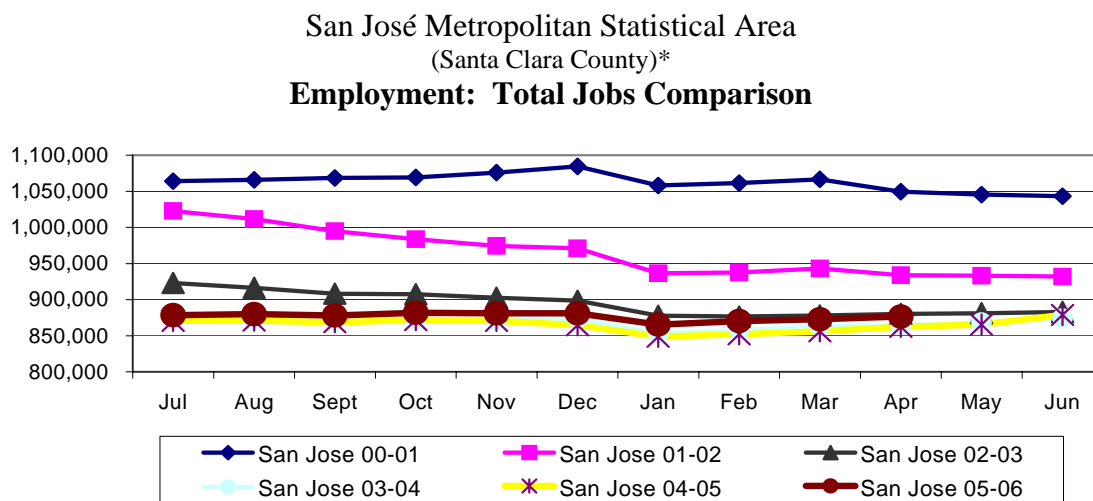
Locally, the economy continues to exhibit positive signs in the current year. Through the first ten months of the year, as we have been reporting for some months, we are continuing to experience growth in our largest revenue sources that has exceeded expectations and revenue estimates included in the Adopted Budget in a number of key categories. As a result, we were able to again up our estimate for General Fund Ending Fund Balance for this year in the 2006-2007 Proposed Budget, to a level above the increased estimate for that source introduced in the February Five-year Forecast. This has provided additional one-time funding which in the Proposed Budget was recommended to be placed in reserve and/or be used to address some critical unmet infrastructure needs.

As pleasant as it is to report higher than budgeted revenue collections, we remain cautious as to prospects for the future. As has been reported for the last several years, we continue to believe that the most reliable predictor of future economic improvement remains the local employment situation. Although that situation has clearly stabilized, and we are even seeing signs of very modest growth levels, there are still absolutely no signs of any near future trend that would begin to regain a significant percentage of the 200,000 plus jobs lost during the slowdown. April employment data once again confirmed that situation as unchanged. The Valley gained a mere 3,800 jobs between March 2006 and April 2006. Year over year employment for the period of April 2005 to April 2006 saw an increase in overall jobs of just 7,100 or 0.8%. The unemployment rate in Silicon Valley was 4.6% in April 2006, compared to 4.8% for the State and 4.5% for the nation during the same period. Although the year over year increase of 7,100 jobs is better than the downward spiral of job losses experienced over the past few years, as noted on the chart below, this movement is not enough to indicate a rebound of any significance.

As Stephen Levy, director of the Center for the Continuing Study of the California Economy stated when talking about the Silicon Valley job increase: "It's modest, but it is positive. The downturn is over in jobs now. But I wouldn't go crazy over it."

On an overall basis, therefore, we continue to believe that current trends are consistent with revenue estimates included in both the 2006-2007 Proposed Budget, and the recent five-year General Fund Forecast. We see a continuation of modest growth, as assumed in the projections contained in those documents. On a longer term basis, we continue to believe that even with the improved economic environment; the City will face difficulties matching the growth levels in existing program costs, and will face an even larger task in attempting to finance the costs of new facilities, growing demands to restore recently reduced program services, and ever larger infrastructure backlogs.

OVERVIEW (CONT'D.)



* The data in the above Chart has been retroactively updated to conform to the new MSA boundaries implemented by the Bureau of Labor Statistics starting in January.

As discussed above, our review of the City's General Fund revenue performance to date indicates that revenue collections continue to exceed estimates on an overall basis. In particular, as discussed in more detail later in this report, collections in our largest General Fund revenue source, Property Tax, are well above estimated levels, reflecting both stronger than anticipated Secured Property Tax values and a better than anticipated outcome of the State budget actions swapping Vehicle License Fees for Property Tax receipts. In addition, recent information from the County concerning SB 813 Property Taxes (supplemental taxes), which have historically been very volatile, indicates that this category of Property Taxes may end the year substantially higher than initial county predictions.

The news concerning our second largest General Fund revenue source, Sales Tax, is more mixed. As reported in the Mid-Year Budget Review, first quarter Sales Tax receipts experienced strong, unadjusted growth of 14.5%. Also as reported in the previous MFR, the City's Sales Tax consultants indicated that they also expected growth levels of 2% to 3%, consistent with our budgeted growth estimate, as the most likely scenario for the remainder of the fiscal year. In March, we received the second quarter Sales Tax collection results. Collections for that quarter were up a much more modest 2.3% from the prior year level, consistent with the 2.0% estimate contained in the 2005-2006 Adopted Budget. Although we will not receive information regarding third quarter Sales Tax collections until late June, it is expected that the more modest 2.0% estimate contained in the 2005-2006 Adopted Budget continues to be the most likely scenario.

In summary, General Fund revenue collection levels through ten months of the year are exceeding expectations on an overall basis, and barring significant setbacks, will end the year above budgeted levels.

On the expenditure side, with the exception of three departments (Employee Services, Public Works, and the Finance Department—Stores Fund), and two City-wide categories (Hayes

OVERVIEW (CONT'D.)

Mansion subsidy and Team San Jose), as discussed later in this report, all other departmental and City Wide appropriations in all funds appeared to be running at or below budgeted levels through April. As is the case with General Fund revenues, on an overall basis there should be higher than previously anticipated year-end savings available by year-end.

It should also be noted that despite the relatively positive news concerning the performance of the current year budget, in light of the belief that the City faces another major budgetary shortfall next year, the Administration is keeping in place all of the aggressive cost control measures implemented over the last several years. A city-wide hiring freeze is now in its fifth year. Also, continuing are most of the controls directed by Council in April 2003 on various non-essential expenditure categories (e.g., overtime, travel, technology purchases, and marketing).

GENERAL FUND

REVENUES

General Fund revenues through April 2006 totaled \$552.3 million. This was an increase of \$43.0 million (8.4%) from April 2005 level of \$509.3 million. This performance reflected timing differences in revenues between the current and the prior year, along with the previously discussed improvement in the economic environment resulting in increases in the following revenue categories: Property Tax; Sales Tax; Transient Occupancy Tax; Franchise Fees; Utility Tax; Licenses and Permits; Fines, Forfeits, and Penalties; Use of Money and Property; Revenue from the Federal Government; and Other Revenue.

Increases in those categories were partially offset by decreases in two revenue categories: Revenue from Local Agencies; and Revenue from the State of California.

The following discussion highlights General Fund revenue activities through April:

KEY GENERAL FUND REVENUES (\$000's)

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Property tax	\$ 157,996	\$ 125,428

Year-to-date Property Tax revenues reflect collections in Secured Property Tax, Unsecured Property Tax and the smallest property tax category, SB 813 Property Taxes (supplemental taxes).

Projections for the Property Tax revenue category are running above estimates primarily due to higher than anticipated Secured Property Tax roll growth. Secured Property Tax revenues of \$107.6 million through April were 16.2% higher than the prior year, and the best information available from the County indicates that the City is on track to slightly exceed the current revised

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Property Tax (Cont'd)	\$ 157,996	\$ 125,428

budget estimate of \$140.5 million (An upward adjustment primarily reflecting the impact of the VLF Swap totaling \$11.6 million was approved as part of the Mid-Year Budget Review). It should be noted, however, that tax roll adjustments are still occurring and will continue to take place until the end of May. As a result, final conclusions concerning the status of Secured Property Taxes will not be possible until total receipts are received in July.

With adjustments for accrual reversals and timing differences, the \$6.8 million total for SB 813 Property Taxes (supplemental taxes) for the current fiscal year through April is 65.6% higher than last year's comparable collections of \$4.1 million. This large increase is entirely the result of a side effect of the conversion of VLF to Property Tax inherent in the "VLF Swap", as explained in prior MFRs and in the Mid-Year Budget Review, which has increased the ratio of the City's allocated share of SB 813 Property Taxes. The total magnitude of the impact of this change in ratio has been even greater than originally expected. Even after taking into account a \$2.4 million upward adjustment approved as part of the Mid-Year Budget Review, this revenue has already exceeded the revised budget estimates of \$6.0 million. In fact, current conversations with the County indicate that this category could end the year in the range of \$9.0 million to \$10.0 million.

As the VLF Swap was advertised and apparently intended to be a relatively neutral transaction, we are still somewhat concerned about the reliability of these projections for a significantly positive outcome. If, for example, the additional property tax revenue which we are experiencing is later determined to result to any significant extent from missed projections at the State level regarding the impact of the VLF Swap, there may be some risk that the State would attempt to recover revenue collections deemed to be above and beyond the intended revenue neutral design. For that reason we urge caution concerning the final availability of this additional revenue.

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through April, Unsecured Property Tax receipts of \$10.5 million are slightly lower (down 3.3%) than last year's level.

Finally, it should also be noted that tax roll adjustments are still occurring. The Budget Office is continuing to work with the County to assess what implications any fluctuation in revenues due to this factor might have for the prospects of growth in the overall Secured Property Tax category.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2005-2006 Estimate</u>	<u>YTD Actual</u>
Sales Tax	\$ 135,243	\$ 85, 119

General Sales Tax receipts for April represented only State formula advance payments, including approximately one half (\$12.7 million) of the triple flip receipts described in previous MFRs. Collections of \$81.8 million tracked 1.1% higher than the \$80.9 million collection in the prior year. Although, due to the triple flip, the City is now receiving reduced advance payments, the receipt of the first half of the triple flip amounts have provided reimbursement of the advances for the first half of the year.

As discussed in the overview, Sales Tax collections were very uneven over the first two quarters of the year, and information on third quarter collections will not be available until late June. Information from MBIA MuniServices, the City's Sales Tax consultants, indicates, however, that the most likely scenario for the remainder of the year is the modest 2.0% increase consistent with the Adopted Budget estimate and the estimates used in the recently released Five-Year Forecast. The increase in energy costs, the recent slowdown in the housing market, and the Federal Reserve's implied intentions to continue increasing interest rates continue to cause us to conclude that we should not count anything other than the budgeted modest increase level in this revenue category.

<u>Revenue</u>	<u>2005-2006 Estimate</u>	<u>YTD Actual</u>
Transient Occupancy Tax	\$ 6,450	\$ 5,649

Transient Occupancy Tax collections through April of \$5.6 million were well above last year's level of \$4.6 million for the same period. Both as a result of a stronger than anticipated performance in 2004-2005, and a significant growth in receipts for the current year, we are running at a level that would well exceed budgeted expectations by year-end. The budget had assumed modest growth from prior year levels of 4%. Currently, collections are instead up by 23% from 2004-2005 levels through April. The average room rate rose at a significant level compared to last year – \$119.88 in April 2005 to \$135.71 in April 2006. More notable, however, was the month over prior year month rise in occupancy rates for April. Occupancy rates in April 2005 were 51.2%. Thus, occupancy rates that skyrocketed in February did not come down as anticipated. April 2006 occupancy rates remained up significantly at 69.9%. We are still concerned, however, that this rate of increase won't be sustained in future months. While it is clear that we are currently enjoying a significant rebound in collections in this economically sensitive revenue category, the extent of the overage will need to be monitored closely for the remainder of the year.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Franchise Fees	\$ 33,402	\$ 26,766

Collections of \$26.8 million from Franchise Fees were above the April 2005 collection level of \$24.0 million. This variance primarily reflects net higher collections in Gas, Cable Television, and Commercial Solid Waste Franchise Fees, slightly offset by a decrease in Electric Franchise Fee collections. It should be noted, however, that the receipts related to Electric and Gas Franchise Fees are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on actual collections in calendar year 2005, which are "trued-up" to actual calendar year 2005 receipts in April 2006. The increase in Gas Franchise Fee receipts, as reported in prior MFRs, is due to the effects of Hurricanes Katrina and Rita that caused a sharp rise in natural gas prices during this winter. Although not as high as first projected, a 24% increase in overall heating bills is expected when compared to the prior year. The effect on Gas Franchise Fees is anticipated to be somewhat less than the expected impact on Gas Utility Taxes, as actual amounts received in 2005-2006 are based on actual calendar year 2005 Electric and Gas Franchise Fees, which were only affected at the end of the calendar year. It is currently estimated, however, that Gas Franchise Fees will end the year well above the budgeted estimate.

Commercial Solid Waste Franchise Fee collections of \$8.7 million to date are approximately 12.6% above the prior year level of \$7.7 million. Preliminary analysis indicates that this revenue category will also end the year above the budgeted estimate.

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Utility Tax	\$ 74,771	\$ 59,470

Utility Tax collections of \$59.5 million were above (up 6.2%) last year's collection level of \$56.0 million. This performance again primarily reflects the impacts from the hurricanes, and other market factors that caused natural gas costs to increase significantly during the short-term, and are expected to result in significantly higher (24.0%) collections of Gas Utility Taxes in 2005-2006 when compared to collections received in 2004-2005.

As noted under the Franchise Fee category discussion above, a sharp rise in natural gas prices has occurred during the winter months. Accordingly, a \$3.9 million upward adjustment was approved as part of the Mid-Year Budget Review. Although the total impact is still unknown at this time, it is estimated that Gas Utility Tax collections will meet the revised budgeted estimate by year-end. In addition, the 2005-2006 Adopted Budget for Telephone Utility Tax was based

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Utility Tax	\$ 74,771	\$ 59,470

on an estimated decline of 2% from a year-end estimate of \$19.8 million. As actual year-end receipts in 2004-2005 were significantly higher (\$23.0 million) than the year-end estimate, a \$3.0 million upward adjustment was approved as part of the Mid-Year Budget Review. Even with this adjustment, it is estimated that 2005-2006 year-end receipts for Telephone Utility Tax will be higher than the revised budgeted estimate.

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Licenses and Permits	\$ 72,667	\$ 63,515

On an overall basis Licenses and Permits revenue of \$63.5 million through April was 3.1% above the prior year level of \$61.6 million.

Cardroom Business Tax collections of \$8.3 million were well above the prior year level of \$7.2 million. This revenue category is expected to exceed budgeted expectations of \$8.5 million.

Disposal Facility Tax revenue of \$10.1 million was below the prior year level of \$10.9 million. Although partially reflecting timing differences between collections in the two years, this performance primarily reflects the impact of a recent agreement resolving the dispute between the City and the BFI and Waste Management corporations regarding the removal of the Alternate Daily Cover exemption approved by The City Council in 2002-2003. As a result of the agreement, the City has agreed to reinstate the Alternate Daily Cover exemption and reimburse Waste Management for the disputed amount they paid the City in 2003-2004, including interest. Although calculation of the final payment amounts, including related interest, is still under discussion, it is expected that the total amount will be approximately \$1.3 million. This impact was not anticipated in the revenue estimate for this category included in the Adopted Budget, and it is anticipated that collections in this category will end the year below the budgeted estimate by approximately that amount.

Fire Permit collections through February of \$6.9 million were 16.5% above the prior year level of \$5.9 million. After an upward adjustment of \$39,000 approved as part of the Mid-Year Budget Review in Fire Code Plan Check fees, the current year revenue estimate now presumes a slight increase (0.7%) compared to 2004-2005 actual year-end receipts of \$6.5 million. These estimates were built assuming a continuation of activity levels of last year, which included a restructure of existing development-related service fees to hourly fees; and the establishment of

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES

(\$000's) (Cont'd.)

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Licenses and Permits (Cont'd.)	\$ 72,667	\$ 63,515

new fees for single-family plan review, hazardous materials plan check (express and intermediate) and Temporary Certificate of Occupancy Processing activities.

Revenue from Annual Renewable Permits (Non-Development) are tracking at estimated levels, while Non-Renewable Permits and Plan Check (Development) activities are tracking above anticipated levels due to higher than anticipated development activities. Inspection and plan check activities were higher than anticipated due to several high-rise projects and an increase in commercial and industrial construction activity. This higher than anticipated development activity is expected to continue through the rest of this fiscal year with anticipated submittals of high-rise and multi-family developments. As a result, total Fire Permits revenues are expected to end the year above the estimated level of \$6.5 million.

Building Permit revenues of \$20.3 million were also tracking above the budgeted level and above (1.9%) last year's collection level of \$20.0 million. Revenues in all categories except for New Residential-Building Permits, Plumbing Permits, Electrical Permits, and Mechanical Permits are performing above anticipated levels, and if continued at those levels, would end the year above budgeted estimates. In order to respond to this additional workload and to concerns raised at the Getting Families Back to Work Study Session, three additional positions were approved as part of the Mid-Year Budget Review. Residential building permits activity in April, however, was at a three and a half year low, while commercial activity was slow and no new industrial construction permits were issued.

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Fines, Forfeitures, and Penalties	\$ 12,695	\$ 11,492

Fines, Forfeitures, and Penalties collections of \$11.5 million to date are approximately 10.1% above the prior year level of \$10.4 million. Preliminary analysis indicates, however, that this performance actually represents only timing differences in receipts and variances in accruals compared to the previous year. Current indications are that this revenue category is on track to meet, or slightly exceed, budgeted expectations by year-end.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2005-2006 Estimate</u>	<u>YTD Actual</u>
Use of Money and Property	\$ 6,217	\$ 7,920

The Use of Money and Property revenue of \$7.9 million in April was well above the prior year level of \$5.6 million, reflecting higher than anticipated interest rates and investment earnings. The Federal Reserve has increased interest rates 16 times since the Fed began tightening credit in June 2004, and indicated that there is a likelihood of further rate hikes. The increases in the rates have resulted in an increase in interest income for the City. In the current environment, it is expected that this category could end the year as much as \$2.0 million above the current budget estimate.

<u>Revenue</u>	<u>2005-2006 Estimate</u>	<u>YTD Actual</u>
Revenue from Local Agencies	\$ 42,981	\$ 31,955

Revenue from Local Agencies of \$32.0 million through April was 16.1% below the prior year level of \$38.1 million. This variance was primarily driven by the timing of when payments are received such as grants received in one year and not the next. Revenues in this category are, at this point, still expected to end the year within budget.

<u>Revenue</u>	<u>2005-2006 Estimate</u>	<u>YTD Actual</u>
Revenue from State of California	\$ 12,413	\$ 9,296

Revenues from the State of California of \$9.3 million through April were 20.5% below prior year collections of \$11.7 million. In 2004-2005, as a result of State budget balancing actions, State Vehicle License Fees (VLF) were reduced by a State determined amount (\$49.4 million), and, in turn, are now reimbursed to the City as Property Tax, scheduled to be received in January and May each year. These Property Tax In-Lieu of VLF receipts are scheduled to be reduced in 2005-2006 (as they were in 2004-2005) by the amount determined to be the City's contribution to the State budget balancing plan (\$11.1 million). The reduced monthly receipts for VLF did not start until October 2004, with the City receiving higher (Pre-VLF Swap) monthly receipts for VLF in the first three months of 2004. After taking this VLF Swap difference into account, revenues in this category were actually relatively flat and it is expected that revenue collections in this category will meet, or exceed, budgeted estimates by year-end.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Departmental Charges		
-Public Works	\$ 7,100	\$ 5,818

Public Works revenue through April of \$5.8 million was only slightly (2.5%) below the prior year level. Revenue activity in this category tends to have fluctuations during the year and it is expected that revenue collections should smooth out as the year progresses.

- Police	\$ 1,243	\$ 1,216
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Police revenues of \$1.2 million through April tracked above expected levels and 8.3% higher than the prior year's level of \$1.1 million. When compared to 2004-2005, higher revenues were received for Tow Service Dispatch, Vehicle Impound, and Police Records/Reports. At this time, it is expected that revenue from this category will exceed the current estimate of \$1.2 million.

- Planning, Building, & Code Enforcement	\$ 5,631	\$ 4,219
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Planning Permit revenue of \$4.2 million through April was slightly (0.9%) above last year's collection level and tracking slightly (5.9%) below anticipated levels. Revenue activity for 2005-2006 assumed the same level of activity as 2004-2005, with fee increases. If current collection levels continue, revenues in this category could end the year as much as \$200,000 under budget.

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Other Revenue	\$ 21,887	\$ 14,185

Other Revenue collections of \$14.2 million were \$4.0 million above the prior level of \$10.2 million. This increase from the prior year primarily reflects timing differences regarding the reimbursement received from the Arena Authority as compared to the prior year level. Due to the NHL lockout situation in the prior year, and a dispute regarding the amount the Sharks owed under that situation, the payment received last year in October was placed into the Depositor's Fund, pending resolution of outstanding issues, and not posted to the General Fund until much later in 2004-2005. In the current year, the \$3.5 million of receipts have been posted in the General Fund as they were received. Discussions between the Sharks organization and the City Attorney's Office continue regarding prior year payment issues. With the exception of the above, remaining collections in this category appear to be within budgeted expectations

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
((\$000's) (Cont'd.))

<u>Revenue</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Transfers and Reimbursements	\$ 95,347	\$ 86,912

Transfers and Reimbursement collections of \$86.9 million are above (22.0%) the prior year level of \$71.3 million. The change is actually, however, the result of the timing of various budgeted transfers to the General Fund this year and last year. Overall, collections at this point are expected to meet, or exceed, budgeted estimates.

CASH

General Fund Cash balances at the end of April of \$190.6 million were up slightly when compared to last year. It should be noted, however, that fluctuations in cash this year as compared to prior years in large part reflect different patterns of payment from the State caused by the various budget balancing actions taken that affect City revenues as described above. The slight increase in General Fund Cash balances is, however, a welcome change from the declines in General Fund Cash balances experienced over the past several years. We will be closely monitoring the status of cash balances in the General Fund and reporting to the Council on a regular basis concerning any relevant information or significant changes to these balances.

EXPENDITURES

Through April, General Fund expenditures of \$548.4 million were 0.3% below (down \$1.5 million) the prior year level of \$546.9 million. Encumbrances of \$29.1 million were 4.7% above (\$1.3 million) the prior year level of \$27.8 million. Expenditures and encumbrances (\$577.5 million) through April constitute 73.1% of the total 2005-2006 revised budgeted uses of funds (\$790.5 million, excluding reserves).

On an overall basis, after incorporating the adjustments approved as part of the Mid-Year Budget Review, cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through April. However, the Stores Fund, the Public Works Program Support Fund, and Public Works Department, the Employee Services Department, as well as City-Wide appropriations for Team San Jose and the Hayes Mansion subsidy were tracking higher than anticipated through April. A more detailed description of the issues involved can be found below.

The following discussion highlights significant General Fund expenditure issues occurring as of April:

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES

(\$000's) (Cont'd.)

<u>Department</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Police	\$ 241,863	\$ 187,897

On an overall basis, Police Department expenditures continued to track at lower than estimated levels. Overtime expenditures through April tracked slightly below anticipated levels at \$4.5 million or 69.2% of the budgeted level (compared to the estimated level of 80.8%). Personal Services expenditures tracked close to anticipated levels (80.2% compared to the estimated level of 80.8%). In the Sworn Recruitment and Training Program, the Department hired 33 Police recruits for its July 2005 Recruit Academy. These 33 Police recruits graduated from the academy in December 2005 and became street-ready in April 2006. In addition, the Department hired 30 Police recruits for the January 2006 Academy.

The compensatory time balance at the end of April 2006 was 217,414 hours for sworn personnel. This represents a 5,337 hour increase (2.5%) compared to the March 2006 balance of 212,077, and a 15,957 hour increase (8.1%) compared to the April 2005 balance of 196,120. Staff will continue to monitor this balance throughout the year.

A total of 61.9% of the Department's Non-Personal/Equipment budget was expended or encumbered through April. It is estimated that the Department will end the year within its Non-Personal/Equipment allocation.

<u>Department</u>	2005-2006 <u>Budget</u>	YTD <u>Actual</u>
Fire	\$ 126,359	\$ 100,116

Overall, expenditures for the Fire Department were tracking slightly below estimated levels through April (79.5%, compared to a par level of 80.8%). Personal Services expenditures are tracking at estimated levels. Overtime expenses have declined and stabilized and the Department anticipates ending the year within the budgeted personal services allocation.

Hurricane Katrina relief effort reimbursement is anticipated by the State as part of California Task Force 3 (\$226,000) and through the Federal Emergency Management Agency (FEMA) (\$124,000) later in the fiscal year.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES

(\$000's) (Cont'd.)

<u>Department</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Fire (Cont'd.)	\$ 126,359	\$ 100,116

Through April, the Fire Department had a total of 236 filled paramedics (139 front-line, 5 Supervisors, and 92 support). This is compared to the 147 front-line medics that are necessary to fully staff all apparatus. The 18-week firefighter academy concluded on December 16, 2005 with 22 paramedic recruit firefighters graduating. A total of 20 firefighters have completed accreditation, with the final two projected to achieve accreditation in June 2006. With the full certification of these graduates, the Department projects that 141 paramedics will be available to address minimum staffing requirements. The Department began a new recruit academy in April 2006 consisting of 31 recruit paramedics.

The Department's Non-Personal/Equipment budget of \$6.0 million was 76.4% expended through April and is expected to end the year within the budgeted allocation.

<u>Department</u>	2005-2006 <u>Budget</u>	YTD <u>Actual</u>
Employee Services	\$ 5,938	\$ 4,511

Although the Employee Services Department is currently still exceeding budgeted expenditures in their Personal Services Appropriation, significant improvement has been noted through April. The improvement is partly due to vacancy savings from two positions (an Analyst and a Nurse Practitioner). In addition, the Department's personal services may further improve due to an additional Senior Analyst vacancy expected in May. At current rates, the Department would still exceed its personal services budget by approximately \$40,000. It is now expected that non-personal/equipment expenditure savings will be available to cover the personal services overage in a year-end clean-up action.

<u>Department</u>	2005-2006 <u>Budget</u>	YTD <u>Actual</u>
Public Works	\$ 7,445	\$ 5,788

Public Works Department Personal Services expenditures continue to track above budgeted levels. The Department has been working to correct this overage, and significant improvement is noted through April. The overage is the result of Public Works staff budgeted to charge to capital or fee programs, instead charging their time to the General Fund at levels which exceed the budgeted amount.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES

(\$000's) (Cont'd.)

<u>Department</u>	2005-2006 <u>Estimate</u>	YTD <u>Actual</u>
Public Works (Cont'd.)	\$ 7,445	\$ 5,788

Public Works staff has been working to shift charges where possible to the appropriate funding source. It is now anticipated that all of these charges can be cleared by year-end to avoid the budget being exceeded. The Budget Office will continue to monitor performance in the Public Works Department and, as necessary, recommend adjustments to resolve this issue as more information becomes available.

<u>Department</u>	<u>Budget</u>	<u>Actual</u>
Team San Jose	\$ 11,631	\$ 8,846

As previously reported, year-end estimates for Team San Jose (TSJ) had projected overages in required City subsidies (over the budgeted levels) for the TSJ contract operations of City Convention facilities. At the May 16, 2006 City Council Meeting, City Council approved a transfer of \$450,000 from TSJ's Personal Services appropriation to the Non-Personal/Equipment appropriation, and also approved a \$500,000 increase in the Non-Personal/Equipment appropriation to provide TSJ with an overall \$950,000 increase to cover TSJ's non-personal operating cost overage through the remainder of the year. With this increased City subsidy of operations, TSJ has pledged to end the year within the revised budgeted estimates.

<u>Department</u>	<u>Budget</u>	<u>Actual</u>
Hayes Mansion Subsidy	\$ 1,600	\$ 1,600

The budgeted General Fund subsidy for the operations of the Hayes Mansion in the current year is \$1.6 million. At current rates of revenue collections and costs incurred, it now appears certain that this subsidy level is below what is necessary to keep the facility in operation through the remainder of the fiscal year. Based on current projections, it appears likely that it will be necessary to increase the current year's subsidy by approximately \$800,000. Funding is available in remaining Hayes Mansion bond funds (\$350,000) to cover a portion of this overrun, but the remainder will require an increase in General Fund support. The problem does not appear to be one of lower than anticipated revenue collections, as the performance for the first eight months of the year is actually up 30% from last year, and slightly above budgeted levels. The primary driver of the overage instead, represents a combination of higher than anticipated debt service, and an unrealized savings target given to the Hayes Mansion operators as part of the current year contract. A full analysis and recommendation for funding regarding this issue is scheduled for the June 20th City Council agenda.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES

(\$000's) (Cont'd.)

<u>Department</u>	<u>2005-2006 Estimate</u>	<u>YTD Actual</u>
Hayes Mansion Subsidy (Cont'd.)	\$ 1,600	\$ 1,600

In addition, as part of the 2006-2007 Five-Year Forecast, expectations for required subsidy levels for the Hayes Mansion were raised, primarily due to full utilization of the existing \$5 million line of credit with Comerica bank, which the Hayes Mansion has been reliant upon to subsidize operations in the past. Current estimates for subsidy levels required for at least the next several years total approximately \$4.2 million annually.

CONTINGENCY RESERVE

Through April, the General Fund Contingency Reserve was at \$22,969,462, down by \$1.9 million from the 2005-2006 Adopted Budget level of \$24,819,462. The following revisions to the Contingency Reserve were approved through April:

- A decrease of \$100,000 to provide funding for the Norcal Garbage Contract investigation.
- A decrease of \$500,000 to support relief and recovery assistance as a result of Hurricane Katrina (restored as part of the Annual Report in October).
- A decrease of \$100,000 for an elections commission evaluator and investigator services.
- An increase of \$100,000 to reflect the return of the amount previously transferred for an elections commission evaluator and investigator services.
- An increase of \$500,000 to reflect the return of the amount previously transferred to support relief and recovery assistance as a result of Hurricane Katrina.
- A decrease of \$500,000 to provide funding for an Emergency Response and Preparedness Risk/Threat Assessment.
- A decrease of \$1.3 million to provide funding for the Amended and Restated Agreement to Conduct a San José Grand Prix.

OTHER FUNDS

Construction and Conveyance Tax Funds

Construction and Conveyance Tax revenues are continuing to exceed expectation due to strong activity in the local real estate market earlier in the year. Collections through April totaled \$37.1 million, up 13% from the \$32.9 million collected through April 2005, a year of record collection levels. In addition to these revenues, the City has since received May Conveyance Tax receipts totaling \$4.0 million. This amount was 13% lower than the May 2005 amount of \$4.6 million. This decrease marks the second time within four months that the current year monthly receipt is lower than the prior year. Due to the stronger than anticipated performance of this tax for the first half of the year, the revenue estimate was increased from \$20.0 million to \$44.0 million earlier this year. Even with the softening in the market, collections should be adequate to reach at least that level of collections.

Construction and Conveyance Taxes are almost entirely generated from property transfers, and for the past several months there have been some tangible signs that the long anticipated slowdown in activity in this area has begun. As of April, the number of property transfers for all types of residences has decreased by approximately 17% from the prior year. While the number of transactions is down, the median home price is still up when compared to April 2005. The median home price in April 2006 was \$785,000, up 14% from the April 2005 median home price of \$691,000. However, it should be noted that the amount of time it took to sell these homes has grown tremendously. The average days on market was 36 days in April 2006, which is twice as long as the average of 18 days in April 2005. Furthermore, the average days on market has increased steadily since a low of 15 days in June 2005.

Other Construction-Related Revenues

Through April, permit valuation for residential and commercial construction activity is below prior year levels. The number of residential dwelling units has decreased 11.8% and commercial construction activity has decreased 12.6% from the same period last year. A foundation permit was issued for a mixed-use project consisting of 57 dwelling units and 7,700 square feet of commercial space, located on a 1.1-acre site at the southwest corner of Winchester Boulevard and Loma Verde Drive in the Winchester SNI area. Permits were issued for two secondary dwelling units pursuant to the City's twelve-month pilot program. These units are located at Bundy Avenue and 1140 Marengo Lane. Commercial permits were issued as follows: to Stevens Creek Volkswagen for construction of a 41,000-square foot expansion to their existing facility at the southeast corner of Stevens Creek Boulevard and Palace Drive; for a 13,600-square foot retail/office complex located on a 0.9-acre site on the west side of Winchester Boulevard; and for Bel-Air Plaza, a 11,000-square foot retail project located on a 1.1-acre site at the southwest corner of Highway 101 and North First Street. In contrast, industrial permit activity has increased by 13.1% from the same period last year. The development permit activity drives the revenue collection in several categories, including the Construction Excise tax, Building and Structure Construction Tax, and Residential Construction Tax, and is an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.

OTHER FUNDS (CONT'D.)

Other Construction-Related Revenues (Cont'd.)

Through April, actual receipts for the seven revenue sources monitored for this report totaled \$21.3 million, which represents a decrease of 6.7% from the \$22.8 million collected through the same period last year. The major revenue sources – Building and Structure Construction Taxes and Construction Excise Taxes – tracked lower than in 2004-2005 but are close to budgeted estimates. Building and Structure Tax receipts through April totaled \$7.9 million, which is 91.4% of the 2005-2006 estimated level of \$8.7 million. This represents a decrease of 7.8% from the revenues collected through the same period last year (\$8.6 million). The budgeted estimate for this category allows for a 21.3% drop in 2005-2006. Construction Excise Tax revenues through April totaled \$11.4 million (85.1% of the current 2005-2006 estimate of \$13.4 million), which represents a 6.7% decrease from last year's \$12.2 million received over the same period. The budgeted estimate for this category allows for a 12.2% drop in 2005-2006.

Other construction-related revenues are generated by Residential Construction Taxes, Municipal Water Service Connection Fees, Municipal Water Major Facilities Fees, Sanitary Sewer Fees, and Storm Drain Fees. The Sanitary Sewer Fees, Storm Drain Fees, and Residential Construction Taxes are tracking above prior year levels and have exceeded or are within estimated levels for 2005-2006. Sanitary Storm Fees totaled \$1.1 million, which is 103.5% of the current 2005-2006 estimate of \$1.06 million. This collection level represents a 13.4% increase from the fees received through the same period last year (\$955,000). Storm Drain Fees totaled \$482,000 (98.5% of the current 2005-2006 estimate of \$490,000). This collection level represents a 6.9% increase from the fees received through the same period last year (\$451,000). Residential Construction Taxes through April totaled \$246,000, which is 116.0% of the 2005-2006 estimated level of \$212,000.

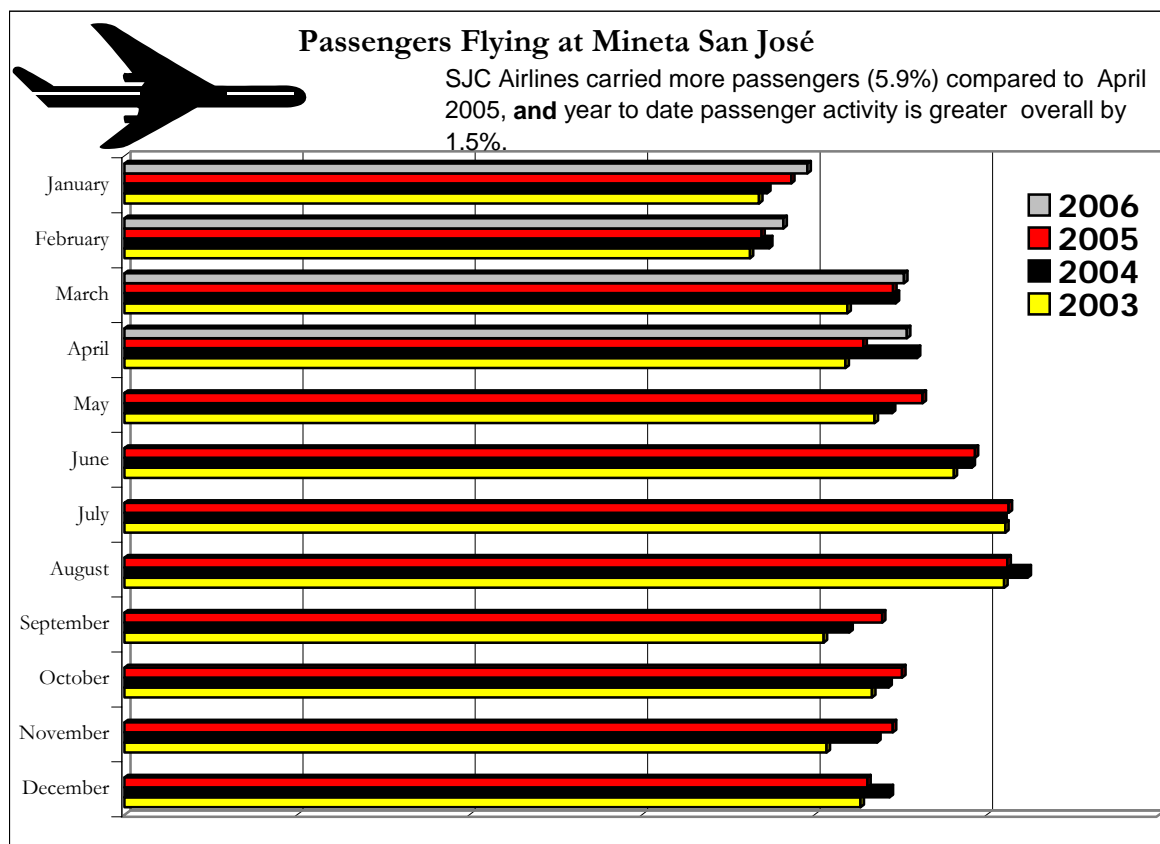
Municipal Water Major Facilities Fees totaled \$34,000 (22.7% of the current 2005-2006 estimate of \$150,000). This collection level represents an 86.1% decrease from the fees received through the same period last year (\$245,000) and may not meet budgeted estimates by year-end. Municipal Water Service Connection Fees totaled \$145,000 (42.7% of the current 2005-2006 estimate of \$340,000). This collection level represents a 39.2% increase from the fees received through the same period last year (\$104,000) but is below estimated levels. Because Municipal Water Major Facilities Fee and Municipal Water Service Connection Fee revenues recover actual costs to install new services, this collection level is coupled with lower costs as well.

OTHER FUNDS (CONT'D.)

Airport Funds

On a fiscal year-to-date basis, the Mineta San José International Airport (SJC) has enplaned and deplaned 9.0 million passengers, an increase of 1.5% from the figures reported through April 2005. Monthly passenger activity for April exceeded that of last April by 5.9%.

Terminal C passenger activity for April 2006 increased 11.4% while year-to-date activity was up by 9.3%. Terminal A activity increased 2.7% in April to April comparisons but is 3.5% lower than the year-to-date figure reported through April 2005. Fiscal year-to-date mail, freight and cargo totaled 173.4 million pounds, which represents a 9.3% decrease from 2005. Passenger Facility Charge (PFC) revenues to date are 3.2% greater than those of last year.



Performance results are mixed across all revenue categories but on an overall basis, year-to-date operating revenues of \$90.3 million through April 2006 inched 1% above the estimated budget. Terminal rentals performed fairly steady with the prorated budget and the rest of the revenue categories, except parking and roadway, are tracking ahead of the forecast. Lower-than-expected collections in both short-term and long-term parking continued to drag down the performance of parking and roadway, which trailed the estimates by 5%.

OTHER FUNDS (CONT'D.)

Airport Funds (Cont'd.)

Revenues performing positively with the estimated levels are landing fees, airfield, terminal concessions and miscellaneous rents, general and non-aviation revenues, and petroleum program. Despite the decline in the activity of American, Frontier, Northwest, and United, total landing fees rose 2% above the projections primarily due to higher-than-expected revenues by majority of the airlines, combined with the revenues from the advent of operations by Hawaiian Air. Airfield trended 9% higher than estimated due to increased revenues across all sectors within the category. Terminal concessions and miscellaneous rents exceeded the prorated budget by 7% mainly because of higher rental car concession fees and advertising fees as well. Higher land rental fees from Park N Travel and receipt of security costs reimbursement from Transportation Security Administration (TSA), in addition to higher-than-expected interest income on investments and transfers from the Fiscal Agent – all drove general and non-aviation revenues above the budget. The Petroleum program is tracking 4% higher than estimated due primarily to surging CNG fuel sales.

Through April, Airport Maintenance and Operation Fund expenditures are tracking below budgeted levels in both Personal and Non-personal/Equipment Services. Personal Services expenditures total 77.7% of budget compared to the estimated budget benchmark of 80.8%. Non-personal/Equipment expenditures total \$24.8 million or 62.0% of the budget compared to the estimated budget benchmark of 75.9%. With overhead transfers now up to date Non-personal/Equipment expenses are in line with the previous fiscal year. Current encumbrances total \$9.4 million, bringing total Non-personal/Equipment commitments to \$34.2 million or 85.5% of budget.

Year-to-date fee revenues in the Airport Customer Facilities and Transportation Fee Fund total \$3.3 million, approximately 1.5% above anticipated budget and 4.8% above the prior year levels. Current month expenditures in the Airport Customer Facilities and Transportation Fee Fund of \$3.5 million are 8.3% less than anticipated through April.

Finance Department – Stores Fund

Since the February MFR, the Stores Fund has shown significant improvement. Although overall revenues are tracking slightly below estimates, collections are significantly improved, reflecting the Finance Department's work at bringing the charges to other departments up-to-date. Expenditures are also tracking lower than expected (\$458,000), but not at a level necessary to offset the revenue shortfall. In April, the Finance Department sent out a memo to the City Departments informing them of the pending retroactive increase to impose an appropriate administrative surcharge to departments in order to recover costs related to management of the Stores-related activities. This surcharge increase is intended to bring revenues close to expenditure level estimates by the end of the year, allowing the overall fund balance to remain at or close to the budgeted level. .

OTHER FUNDS (CONT'D.)

Transient Occupancy Tax Fund

Transient Occupancy Tax (TOT) collections of \$8.6 million through April were well above both prior year collection and budgeted levels. As described earlier in the discussion of General Fund Transient Occupancy Tax collections, the average room rate increased in April from \$119.88 in April 2005 to \$135.71 in April 2006, while the number of available rooms remained relatively unchanged. Occupancy rates, however, experienced significant increases all through the year, resulting in more revenue per available room when compared to the prior year. This has translated into an increase in overall revenue. Collections for the year are now expected to exceed the budget in this fund by up to \$1.2 million.

Public Works Program Support Fund

Overall revenues are tracking significantly lower than expected (\$1.1 million below the anticipated level), due to insufficient charges to the projects resulting in not enough revenue to fully recover program support costs in this Intergovernmental (cost-recovery) fund. Before the end of the year, the Finance Department intends to retroactively impose and appropriate administrative surcharge to projects in order to recover costs related to Public Works program support related activities. This surcharge increase is intended to bring revenues close to expenditure level estimates, allowing the overall fund balance to remain at or close to the budgeted level.

CONCLUSION

After completing ten months of the year, it is becoming clear that the current year has seen a return to historically modest growth in City revenues, resulting in a performance that is slightly ahead of the conservative estimates used to formulate the 2005-2006 Adopted Budget. As programmed in the 2006-2007 Proposed Budget, our assessment of the financial status of the City now indicates that we will end the year with an overall surplus in General Fund ending fund balances.

As discussed previously, although it is now clear that the Valley economy has stabilized from its long downward slide, and is beginning to experience signs of an overall modest improvement, we continue to have concerns in the short term regarding a lack of robust job creation and the impact of a softening housing market. As for the City's longer term prospects, as we have mentioned in past MFRs, even with the positive news regarding the current year budget it is still important to note that for the General Fund, even taking into account the resumption of modest growth in revenues, our projections continue to indicate that the growth in expenditure requirements will outpace the anticipated rate of growth in revenue collections into the foreseeable future. In addition, we must also contend with potential threats to several existing General Fund revenue sources. For example, the current June Mayor's Budget Message proposes extending the sunset provision of the Emergency Communication System Support Fee for 2 and ½ years, which makes counting on this \$21.6 million revenue as a long term funding source difficult. In addition, significant concerns have just recently been raised regarding the City's Telephone Utility User's Tax (UT).

CONCLUSION (CONT'D.)

These concerns center on recent reports that the U.S. Treasury Department conceded a legal dispute challenging the long-distant portion of the Federal Excise Tax (FET). Because the FET is referenced in our City UUT ordinance, if the FET were to be repealed, there could be legal issues regarding the continued collection of all of this revenue source, which is estimated at \$24.8 million in the 2006-2007 Proposed Budget. As a result of these various concerns therefore, it is clear that the City needs to continue to exercise extreme caution in fiscal decision making in order to maintain our historically strong financial status.

It is also true, however, that given the length and severity of the economic disruption we have faced, we can all continue to take considerable pride in the fact that we weathered the situation with our core services reduced but still basically intact, while retaining the City's historically positive reputation for strong and conservative fiscal management. As would be expected, our efforts in planning for the future year budget will be dedicated to retaining that status.

As always, staff will continue to closely monitor our current year financial status and report to the City Council any and all significant development through this reporting process.

/s/
LARRY D. LISENBEE
Budget Director